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C O N F I D E N T I A L SECTION 01 OF 04 TUNIS 001257

SIPDIS

STATE FOR EB AND NEA/MAG
STATE (DESKOFF LAWRENCE) PLEASE PASS TO COMMERCE FOR
ITA/MAC/ONE (DAVID ROTH) AND ADVOCACY CENTER (CHRIS JAMES)
AND TO USTR (DOUG BELL)
CASABLANCA FOR FCS (GAIL DEL ROSAL)

E.O. 12958: DECL: 06/10/2015
TAGS: ECON EFIN ETRD TS EFTA
SUBJECT: EVE OF TIFA COUNCIL: WHERE DOES TUNISIA STAND ON
ECONOMIC REFORMS?

REF: 04 TUNIS 2422

Classified By: Charge d'Affaires a.i. David Ballard; Reasons: 1.4(b),(d
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¶1. (C) Summary. Tunisia has taken the fundamental decision to liberalize its economy after decades of state-control, but progress has been deliberate and mostly limited to sectors that do not threaten the GOT's prerogative or ultimate "sovereignty". The GOT justifies its approach in terms of minimizing near-term unemployment that increased foreign competition will likely create, and managing the threat of Islamic fundamentalism which could feed on economic instability. Nonetheless, the GOT knows that it must reform the economy (privatization, removal of trade barriers, and increased foreign investment) to satisfy internal demographic trends and demands and compete globally. An important element of future reform hinges on a further privatization and modernization of banks; the banking sector suffers from excessive non-performing loans tied to weaknesses in an over-built hotel (vice tourism) industry. Additionally, Tunisia's non-convertible currency, the dinar, limits foreign investment and movement of capital.

¶2. (C) Tunisia's gradualist approach to economic reform is also linked to generous European Union assistance programs and an Association agreement that have permitted the Tunisians to defer reforms in the sensitive agricultural and services sectors, reinforcing at the same time the EU's historical presence as main trade and investment partner. That said, we believe the GOT leadership has made the political decision to pursue an FTA with the U.S. and is willing to take steps in that direction; what remains is working with the ministers and technocrats who are charged with making sure the process maximizes the benefits to Tunisia, minimizes or eliminates negative side effects, and does not exceed the usual deliberate pace of Tunisian reforms. In that regard, the upcoming Council meeting could be an opportunity to demonstrate how decisive reform in the short term can result in an FTA which will effectively serve Tunisia's interests. End Summary.

Economic Liberalization: Stability and Social Cohesion
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¶3. (C) Tunisia has decided to liberalize its economy to sustain economic growth and job creation, which in turn support maintenance of the political status quo. The GOT's liberalization efforts, however, have been slow and deliberate. The most common concern is job loss, a legitimate issue since up the numbers of university graduates will rise steadily over the next five years from about 300,000 a year to 500,000. The unemployment rate is officially about 14 percent but is probably somewhat higher. The GOT links its focus on job growth to staunch policy on containing Islamic extremism (which posed a threat to the government 15 years ago and surfaced again in 2002 with a terrorist attack on a synagogue in southern Tunisia) and maintaining social cohesion. In 1984, for example, Tunisia suffered several days of widespread rioting, violence resulting in 25 deaths, and property destruction due to increases in bread prices. The memory of these "bread riots" is still fresh in the Tunisian collective consciousness.

¶4. (C) Because, in their words, Tunisia is a "small country in a tough neighborhood," officials sometimes appear overly concerned with issues of "sovereignty"; in the economic sphere this means a tendency to retain control over significantly under-valued assets, rather than freeing resources to develop more profitable and gains-multiplying industries that could be subject to foreign whims. Consequently, Tunisia's economic growth has relied principally on public spending and less on private investment. Tunisia views itself as largely self-sufficient and ready to absorb foreign influences, but determined to do so on its on terms.

¶5. (C) Minister of Development and International Cooperation Jouini, who will lead the Tunisian delegation, recently reiterated to A/S Lash the GOT,s strong desire to improve

the business climate and open more sectors of the economy to foreign participation. He also claimed he wants to increase U.S. companies, participation for Tunisia's public tenders. Jouini's has recently been more forward-leaning on reform, stating that he hopes that Tunisia could eventually be seen as a &leader8 in the region through its economic reform efforts--in cooperation with the U.S.--and he has expressed dismay that the level of bilateral trade and commercial relations is far below its potential. Jouini seems to accept the positive impact of increased trade and investment can have on job creation and living standards in Tunisia, but has cautioned that there are some in both the public and private sector who are unconvinced of the value of an FTA. We have welcomed the fact that Jouini and other key Tunisian officials are now more willing to discuss openly structural and policy shortcomings; however they so far continue to maintain that these issues must be addressed only after careful study and discussion. Jouini told the Ambassador that he is coordinating an impact study to determine the effects of an FTA on the Tunisian economy.

Privatization

¶6. (C) As part of the GOT's trend away from macroeconomic control, it encouraged privatizations since the mid-1990s in limited, non-sensitive sectors; it has clearly decided to move more slowly in key industries such as energy and financial services. One successful private sector entrant in 2003 was mobile phone operator Tunisiana, which now claims approximately slightly more than 40 percent of all Tunisia's mobile subscribers; state-owned Tunisie Telecom holds the remainder. Additionally, since 1988, 11 agricultural, 76 industrial, and 98 services companies (mostly in the tourism sector) have been privatized in Tunisia, generating approximately 2.3 billion dinar (USD 1.9 Billion) for the GOT. In the industrial sector, the four largest privatizations have been cement factories. In the services sectors, trade, transportation, financial services have witnessed only limited private sector entries.

¶7. (C) Among the notable privatizations due in the near term: Socit Nationale de Distribution Petroliere, Socit Tunisienne des Industries Pneumatiques, and Banque de Sud. (The GOT offered Banque de Sud for privatization in 2004, but the offer did not attract sufficient interest, probably because a prior bank privatization disclosed massive structural problems (Ref A)). Efforts are now underway to re-launch a number of privatizations, including another shot at Banque de Sud, and a 35 percent share of Tunisie Telecom.

Other Services: Financial and E-Commerce

¶8. (C) GOT fears of capital flight and lack of competitiveness are behind the limits on foreign participation in the financial services sector. Were foreign competition allowed for banking services, insurance and credit offerings, a substantial amount of currency would likely transfer quickly to better providers and significantly damage the current financial establishment. Likewise E-commerce is under-developed in Tunisia; Tunisians are not allowed to make credit card purchases over the Internet in currencies other than in the Tunisian dinar and ATM systems are limited and not linked. Internet penetration is limited estimated at between six and seven percent of the population, many of whom access the Internet only infrequently at public internet establishments.

Foreign Investment

¶9. (C) U.S. foreign investment, while not facing explicit discrimination, is often excluded from greater participation because of cultural barriers, business practices, and language. It is true that a number of U.S. companies have successfully entered into joint venture partnerships, including onshore manufacturing operations in metal casting for aerospace parts, snack food processing, heavy equipment refurbishing and sales, and electrical components. But Tunisia's system of international tenders, for example, offers only two months notification to bidders, requires that documentation must be in French, and rejects bids that do not conform exactly to the detailed requirements. For certain tenders, transparency is a concern, and this has not been addressed by the GOT. Finally, Tunisia's small market (population 10 million and a GDP per capita of about USD 2,800) has meant a traditionally limited U.S. company presence here and word of mouth experience is hard to come by for a potential investor. However, since 1972, Tunisia has encouraged export-oriented, off shore investments, particularly in the manufacturing industry, and this continues to pose good opportunities for U.S. business.

¶10. (C) Tunisian law regulates foreign investment and denies "national treatment" in the agricultural sector, which employs an estimated 22 percent of the population. Onshore companies outside the tourism sector require governmental authorization where foreign capital exceeds 49 percent. Additional foreign investment is likely in the near term, but

it will be heavily weighted toward European interests. The GOT has announced intentions to offer concessions for the following major infrastructure projects: a build-own-transfer project for the construction of an international airport at Enfidah, a desalination plant in Djerba, a deep water port at Hergla, a waste water plant, and a sports complex - the latter four of which are limited to European Union (EU) companies due to EU financing.

Intellectual Property Rights: Pharmaceuticals and Software
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¶11. (C) The well-developed pharmaceutical industry in Tunisia is a significant source of complaints from multinational pharmaceutical producers who claim Tunisia operates outside WTO rules and principles. Tunisia discriminates against and bans foreign pharmaceutical products upon request by a local manufacturer. The GOT has agreed to abolish this practice by the end of 2006, as well as to step up adherence to WTO intellectual property rights principles (TRIPs), but we remain cautious in our assessment of these promises until they are realized.

¶12. (C) Software piracy in Tunisia is significant and appears to be a growing problem. A recent Business Software Alliance report estimates that in 2004, 84 percent of software used is pirated, an increase from 82 percent in 2003. Pirated CDs and DVDs are also ubiquitous in Tunisia, even at major retail establishments. The GOT is well aware of the problem and has expressed the desire to increase enforcement, but blames lack of resources and a "cultural mentality" that does not respect IPR concepts. In this regard, there is also an unstated justification that sales of counterfeit, pirated, and other black-market goods serves to support a significant underground economy that offers employment to many who would otherwise have none.

Market Access and the Removal of Trade Barriers
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¶13. (C) GOT officials have stated that free trade discussions with the U.S. should offer Tunisia at least as good a deal as the Moroccan FTA. Tunisia feels especially vulnerable to opening its agricultural sector, due again to high levels of employment and a popular, cultural connection to farming. Tunisia still maintains high tariffs protecting domestic product markets, especially on agricultural products. U.S. companies also note that exporting to Tunisia is complicated and difficult for a number of reasons, including language, lack of local agent, customs delays and/or rejection of goods, and complicated regulations. Tunisia signed a trade-liberalizing Association Agreement with the EU in 1995 that will eliminate tariffs with the EU by 2008. The discrepancy, however, between the EU's preferred tariff rates structure and most favored nation rates significantly deters non-EU trade with Tunisia.

Transparency

¶14. (C) Tunisian trade-related laws and regulations are receiving better marks on some fronts; Transparency International recently upgraded Tunisia to a "country without a significant corruption problem." Public comment on pending legislation is not a practice in Tunisia, although a system of "national consultation" on important issues does serve to bring stakeholders into the process and all newly-enacted legislation is eventually published in the Official Gazette. Once again, however, in key sectors tenders are closed for unexplained reasons and the arbitrary application of laws is a common complaint. Certain voices within the business community bemoan the growing influence of and requirements for "political connections" to the President's family in order to effectively transact business. In almost every sphere of important economic activity in Tunisia, one can point to if not prove a strong connection or involvement of President Ben Ali's extended family's interests.

Comment

¶15. (C) Despite these challenges, we view our current trade and investment dialogue with the Tunisians as entering a new and positive phase. The Tunisians have begun discussing obstacles and problems more openly, and are more disposed to working with us to address them. The Tunisians who will participate at the upcoming Council meeting are a pragmatic, realistic group who will be interested in determining next steps. The strong impact of a four-year drought and a tourism dip after the 2002 Djerba attack illustrated the structural weaknesses in the economy and in economic policies. There is now a good recognition of the necessity of competing globally and adapting to changes such as the expiration of the WTO's multi-fiber agreement. We view the coming TIFA Council as an excellent opportunity to echo our messages and to engage in exploring where our assistance programs might most positively be advanced.
BALLARD